Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Speier	Analyst:	Darrine Distefano	Bill Number:	SB 1724
Related Bills:	See Legislative History	Telephone:	845-6458	Amended Date:	05-02-2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Child & Dependent Care Refundable Credit

SUMMARY

This bill would conform the California Child and Dependent Care credit to the recent changes made to the federal Child and Dependent Care Expenses credit.

SUMMARY OF AMENDMENTS

The May 5th amendments deleted the provisions that would have denied a deduction for certain lobbying and political expenses and added the language discussed in this analysis.

PURPOSE OF THE BILL

It appears the intent of this bill is to conform to recent changes in federal tax law thus permitting taxpayers to benefit on their California tax return from the increased federal amounts.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. However, since it would apply when the federal law changes apply, the bill would be operative for taxable years beginning on or after January 1, 2003.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law allows a non-refundable tax credit known as the Child and Dependent Care Expenses Credit (federal CDC). In order to take this credit, a taxpayer must have employment related child and dependent care expenses for the care of a qualifying individual.

Board Position:			Department Director	Date
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A qualifying individual for purposes of this credit is any dependent of the taxpayer who is under the age of 13 or a taxpayer's dependent or spouse who is physically or mentally unable to care for himself or herself. Employment-related child and dependent care expenses are generally defined as those expenses incurred to enable gainful employment, e.g., housekeeping, babysitting, and other household services.

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 made the following changes to the federal credit beginning in 2003:

- EGTRRA increases the maximum amount of eligible employment-related expenses or base amounts from $2,400 to $3,000, if there is one qualifying individual and from $4,800 to $6,000, if there are two or more qualifying individuals.
- EGTRRA also increases the maximum credit from 30% to 35%. Thus, the maximum credit is $1,050 if there is one qualifying individual and $2,100 if there are two or more qualifying individuals.
- Finally, EGTRRA modifies the phase-down of the credit. The 35% credit rate is reduced, but not below 20%, by 1 percentage point for each $2,000 (or fraction thereof) of adjusted gross income above $15,000. Therefore, the credit percentage is reduced to 20% for taxpayers with adjusted gross income over $43,000.

Existing state law allows a credit similar to the federal CDC. This credit is known as the Child and Dependent Care Credit (California CDC). Unlike the federal CDC, the California credit is refundable. The amount of the credit is based on a percentage of the taxpayer's federal CDC. The percentages are:

State AGI:	Credit Percentage:
$40,000 or less	63%
Over $40,000 but not over $70,000	53%
Over $70,000 but not over $100,000	42%
Over $100,000	0%

The credit is limited to those taxpayers who maintain a household within the state. The rules under federal law regarding the type of expenses and qualifying individuals apply for California law.

THIS BILL

This bill would conform the California CDC to the provisions contained in EGTRRA affecting the federal CDC. These changes include the increases of the qualified expenses base amount, credit percentage, and phase–out threshold. Since the federal CDC changes do not take effect immediately, this bill would allow the taxpayer to claim an increased California CDC beginning in 2003.

The California CDC would continue to be a percentage of the federal CDC amount and would still be refundable.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

SB 1366 (Kuehl, 2001/2002) would make technical, non-substantive changes to the credit. SB 1366 remains in the Senate Rules committee. AB 847 (LaSuer, 2001/2002) would have increased the state adjusted gross income amounts, removed the language that allowed the credit to be refundable and allowed the credit to be carried over indefinitely. AB 847 failed to pass out of the first house by January 31 of the second year of the session.

AB 480 (Ducheny, Stats. 2000, Ch. 114) created the California CDC.

AB 149 (Leach, 1999/2000) and AB 1728 (Floyd, 1997/1998) would have allowed taxpayers a credit similar to the credit created by AB 480. AB 149 failed to pass out of the first house by January 31 of the second year of the session, and AB 1728 failed passage in the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

Massachusetts allows taxpayers a deduction that exceeds the federal limit on employment related expenses for dependent care services. The maximum deduction is $3,600 for one qualifying individual and $7,200 for two or more qualifying individuals. Unlike California's CDC, it is not refundable and is not based on the taxpayer's federal credit.

Minnesota allows taxpayers a refundable credit similar to California's CDC. However, it is not a percentage of the federal credit but based on household income level. The maximum credit is $720 for one qualifying individual and $1,440 for two or more qualifying individuals. The taxpayer will compare the state amounts to the federal credit amount and claim the lesser of the two.

New York also allows taxpayers a refundable credit similar to California's CDC. It is based on a percentage of the federal credit depending on the amount of the taxpayer's New York AGI. The minimum is 20% up to a maximum of 110% of the federal credit.

Each of these states requires the taxpayers to complete the federal form to calculate the state credit whether or not the taxpayer actually claims the federal credit.

Also, research of these states did not find any current pending or final legislation for conformity to the federal credit contained within the EGTRRA.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in revenue losses as shown in the following table:

Revenue Impact Tax Years Beginning After December 31, 2002 Enactment Assumed After June 30, 2002 ($ Millions)			
Fiscal Year	2002-03	2003-04	2004-05
Child and Dependent Care Services Credit	-6	-39	-40

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The fiscal impact estimates were based on conformity to the federal dependent care credit. California taxpayers would calculate the credit based on the federal credit using current law credit percentages.

Fiscal year 2002-03 is significantly lower than the subsequent fiscal years because it represents the change in estimated payments and withholding between January 2003 and June 2003 for the small portion of taxpayers who would have a response to the change in credit.

LEGISLATIVE STAFF CONTACT

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